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TAGS: [EPET](#) [ENRG](#) [ECON](#) [PREL](#) [RS](#)
SUBJECT: TALKS RESUME ON GAS IMPASSE; STILL NO AGREEMENT ON
MONITORS AND LONG-TERM CONTRACT

Classified By: Ambassador John Beyrle for reasons (1.4 b,d)

Due to technical difficulties message of 1/9 resent 1/12

Summary

1. (C) Gazprom's Aleksei Miller and Naftohaz's Oleh Dubyna met January 9 Sochi and will continue talks in Moscow January 10 (with participation of EC reps) on steps to resume Russian gas deliveries to Europe. The Russian and Ukrainian sides have agreed in principle to establishing a multilateral commission for monitoring gas transit through Ukraine. Gazprom has stated that it is willing to allow Ukrainians to participate in monitoring gas metering stations inside Russia - but claimed the Ukrainians are still balking at having Russian monitors on Ukrainian territory. On the issues of price and supply, Gazprom insists deliveries to Ukraine can only be resumed with a new contract based on market prices for supply and transit of gas. Gazprom claims it is still awaiting payment for Ukraine's past arrears (including late fees and fines). Russian energy analysts are guardedly optimistic that an agreement is imminent. Meanwhile, the Russians appear to be losing the PR war and their reputations as a reliable supplier to Europe. End Summary.

Nearing Agreement On Monitors

2. (C) Our contacts at Gazprom have confirmed that Gazprom's Chief Executive Officer Alexei Miller and Naftohaz's Oleh Dubyna are meeting today (January 9) in Sochi for talks on resuming gas deliveries to Europe. According to Moscow's EC Commission Office, the talks will move to Moscow by tomorrow afternoon and are likely to continue through the weekend. The local EC reps told us that a number of yet unnamed observers from the EC will arrive in Moscow January 10 for the purpose of taking part in the Gazprom/Naftohaz discussions. The trilateral talks will focus on the dispatching of international monitors to oversee the transit of Russian gas to EU states via Ukraine, which would pave the way for the resumption of gas supplies to Europe.

3. (C) In a January 8 statement, Aleksei Miller confirmed that Gazprom has agreed in principle to the establishment of a multilateral commission for monitoring gas transit through Ukraine, which would include representatives from Russia, Ukraine, and the EC. Earlier, the Russians had proposed a

multilateral commission made up of representatives of the Russian and Ukrainian Energy Ministries, Gazprom and Naftohaz, the European Commission, as well as select European gas producers, purchasers, transporters and independent experts - altogether 14 parties. According to the draft Monitoring Protocol Agreement promulgated by Gazprom (dated January 8, available on the GazProm website), the multilateral commission would perform the following:

-- "control the performance of contractual obligations on transit of natural gas through the territory of Ukraine;"

-- "monitor the technical state of the gas transport system of Ukraine (GTS), including underground gas storage on the territory of Ukraine;" and

-- "consider other proposals for optimizing transit of natural gas through the territory of Ukraine."

When that proposal was reportedly refused by the Ukrainians, Miller reiterated that Gazprom was willing to have Ukrainian and EC monitors on Russian territory.

14. (C) However, Ukraine's Ambassador to Moscow, Konstantin Hrishenko, told the Ambassador that the Russians have yet to agree on the conditions for allowing monitors onto their territory. Furthermore, Hrishenko noted, the Russians were trying to change the focus of the monitoring commission from a simple agreement to monitor intake and output points, adding "10-15" parties whom they will require to sign the agreement. This would take days to achieve and was not necessary. The Ukrainians, on the other hand, were ready to

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accept "anyone, anywhere, any time," Hrishenko stated.

15. (C) Konstantin Kosachev of the Duma Committee on Foreign Affairs (and part of Miller's delegation to Brussels) told the Ambassador that Miller made it clear January 8 in Brussels that the Russian side insisted its experts be included in any monitoring on Ukrainian soil, something he said the Ukrainians were objecting to as late as last evening in Brussels. If there was agreement on that issue, Kosachev said, there could be agreement on monitors overall because the Russians had no objection to Ukrainians on Russian soil - in principle.

Unresolved Differences on Pricing and Ukraine's Outstanding Debt

16. (C) In addition to monitors, the Miller-Dubyna talks are covering the unresolved issues of price and supply. Gazprom's negotiating position is based on the proposals Medvedev outlined to Yushchenko on January 7. Resumption of gas shipments to Ukraine is predicated on conclusion of a new contract between Gazprom and Naftohaz. The price of gas would now be market based, based on prevailing rates in Europe, and determined by a pricing formula (details to be negotiated) which would not include discounts or special deals. Gazprom was not able to clarify to us whether raising the price to market levels (approximately \$418 per thousand cubic meters) would in fact violate the October 2008 Tymoskhenko-Putin Memorandum of Understanding that Ukrainian gas prices would approach European prices over three years. Gazprom spokesman Kuprianov's short answer was that the provisions of the MOU were contingent upon the agreement that Naftohaz would repay its existing debt to Gazprom. Gazprom has also indicated a willingness to pay "market" transit fees (\$3-4) provided the Ukrainians agree to pay a "market" based price for future gas shipments.

17. (C) Gazprom continues to insist publicly that Naftohaz has

not paid its debt - although Kuprianov's office acknowledged that Naftohaz has paid \$1.5 billion to RUE, which in turn is supposed to pay Gazprom. It is expected that Naftohaz's \$1.5 billion check will "clear" by January 11, although Gazprom insisted that Naftohaz would still owe about \$615 million in fines and late fees.

Energy Analysts Guardedly Optimistic About a New Contract

18. (C) Moscow-based energy and market analysts are guardedly optimistic that an agreement on prices and supply is doable. RenCap's chief oil and gas analyst Aleskasndr Burganskiy attributed the problem to disorganization within the Ukrainian government and an inability to negotiate and hold to a deal. He viewed EC involvement in the discussions as positive. He believed that an agreement would be reached sooner or later, but did not see any urgency on the Russian side. The agreement, he explained, needed to bring activity closer to market terms and conditions, which was positive from an investor viewpoint. Burganskiy did not believe that the current shut-off would have an impact on Russia's reputation as a reliable supplier, concluding that the Europeans saw Ukraine as the unreliable party in this situation. He also pointed out that the EC did not really have an option but to deal with the Russians. "Do you really think the Iranians are any better?" he asked.

19. (C) Putin delivered a similar message to foreign journalists January 8, in which, in sometimes brusque and impolite language he rejected the idea that Russia's reliability as an energy supplier had been damaged. He pointed the finger at the Ukrainians, accusing them again (as he has on several occasions since the end of December) of stealing gas destined for Central and West European consumers. He went on to encourage the development of alternative routes for energy to European customers, mentioning both the North and South Stream projects as useful in helping to avoid future problems of transit. In the short term, though, he endorsed the presence of observers, including Russians, on Ukrainian territory to certify that

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gas crossing from Russia and intended for European consumers reached them. He vehemently rejected the suggestion that Russia was using energy as a political weapon against Ukraine. He appealed for understanding, asking how he could explain to Russian consumers why Gazprom should offer gas to Ukraine at below market prices, at rates lower than it sells gas in Russia, especially in times of economic difficulty.

Comment

110. (C) With European pressure on Russia (and Putin) increasing daily, we agree that Moscow will see diminishing returns in protracting this standoff. The Russians may be able to boast of some gains over the short term: it is perceived here that the crisis has forced the EU to consider seriously the development of the South stream and North European gas pipelines circumventing Ukraine (and Poland). On the other hand, Russia is suffering major losses in immediate gas revenue and has suffered damage to its reputation as a reliable energy supplier. In spite of the fact that it has retained a PR firm in Brussels to present its side of the story, it appears that Russia is losing the PR war and is less skillful than the Ukrainians in manipulating European public opinion. Some Russian observers say that Putin has been outplayed by the Ukrainians, but cannot back down for fear of losing his domestic reputation for toughness. Medvedev and Putin's attempts to convey Russia's side of the story through foreign journalists shows that they may have learned a lesson or two from the lost media campaign of the Georgia war, even though Russian domestic support remains solidly behind them. End Comment

